

FDIC State Profile

Fall 2005

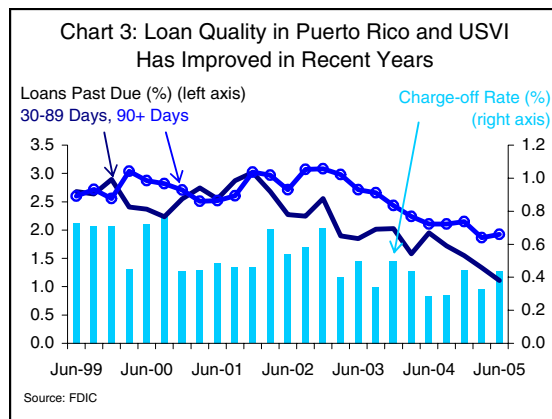
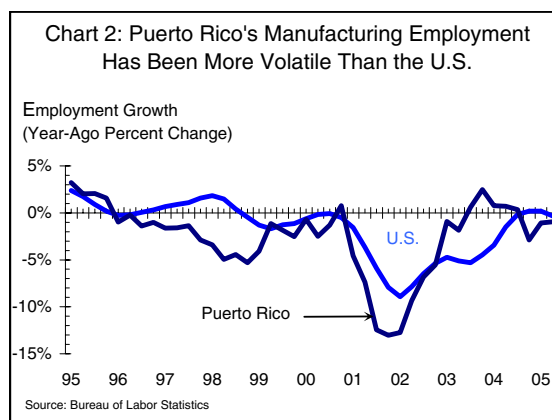
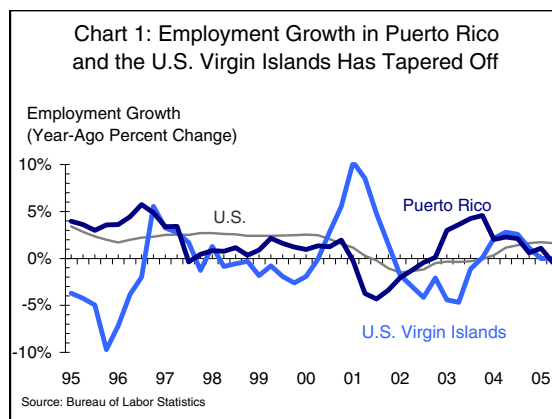
Puerto Rico and the U.S. Virgin Islands

Employment growth in Puerto Rico and the U.S. Virgin Islands (USVI) has decelerated.

- Puerto Rico's employment picture weakened in the first half of 2005, as employment growth turned negative for the first time in three years (see Chart 1). Employment losses in retailing, apparel manufacturing, and administrative services underscore Puerto Rico's sluggish job market. Partially offsetting the weakness were gains in the health, education, and financial service industries.
- Puerto Rico's public sector accounts for approximately one in every three jobs, compared with about one in every six in the United States. After two years of job growth, government employment tapered off to less than 1 percent in the year-ending second quarter 2005, down slightly from previous years.
- Tourism continues to be an important component of Puerto Rico's economy, representing approximately 10 percent of all private-sector jobs. Tourism improved modestly through March 2005 on a year-over-year basis after a weak performance following the 2001 recession. First quarter 2005 cruise ship visitors increased 4 percent, and hotel registrations increased by a similar amount.
- In contrast, weak tourism has had a ripple effect across the USVI economy. With little growth in cruise passenger arrivals through the first half of 2005, the USVI shed jobs in its leisure and hospitality industry, which contributes 70 percent to its gross product.
- A continuation of high-energy costs following the recent hurricanes have the potential to stress the island's consumers and businesses and curtail overall economic growth. Estimates suggest that approximately 70 percent of Puerto Rico's energy needs are from oil.

The rate of manufacturing job losses in Puerto Rico has abated.

- Manufacturing remains Puerto Rico's largest economic sector, representing more than 40 percent of its gross product, compared with 13 percent for the United States. Puerto Rico's manufacturing sector has lost jobs in eight of the past nine years. After losing manufacturing jobs at a greater rate than the nation during the 2001 recession,



the rate of losses during the first half of 2005 approximated the U.S. rate (see Chart 2).

- Increased employment in several high-technology manufacturing sectors—pharmaceuticals, medical technology, and biotechnology—has partially offset the exodus of labor-intensive manufacturing jobs to other lower cost countries.
- Puerto Rico ranked number one in global pharmaceutical exports, claiming about one-quarter of total industry shipments in 2004.¹ In addition, Puerto Rico's exports of medical devices, such as pacemakers and defibrillators, ranked it among the top ten in global exports of these products in 2004.

Credit quality in Puerto Rico and USVI has improved.

- During the past three years, credit quality ratios reported by institutions headquartered in Puerto Rico and USVI have improved (see Chart 3). Consistent with historical trends, loan delinquency and charge-off rates remain well above the U.S. average.
- Credit quality improved across lending sectors; however, improvement could moderate if local employment conditions continue to weaken.

Puerto Rico and USVI banks reported lower profitability compared with one year ago.

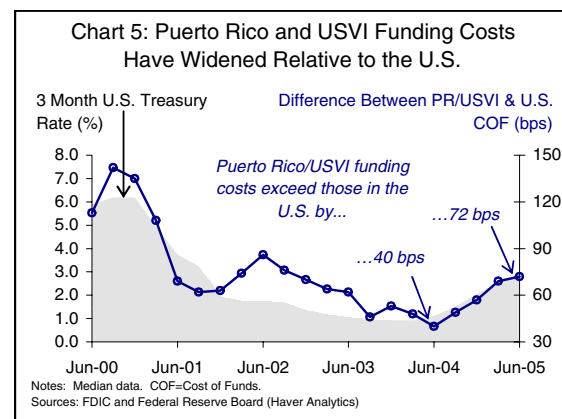
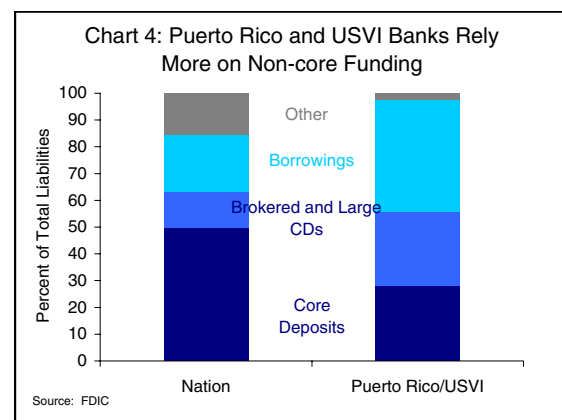
- Banking profitability reported by Puerto Rico and USVI institutions, as measured by return on assets, moderately declined in second quarter 2005 compared with one year ago.
- A flatter yield curve contributed to a decline in the net interest margin (NIM). Asset yields rose with higher market rates. However, increases in funding costs outpaced gains in asset yields, driven by a higher mix of non-core funding among Puerto Rico and USVI banks.

High reliance on non-core funding and rising short-term interest rates contributed to an outsized increase in funding costs.

- Puerto Rico and USVI banks rely more on non-core funding, such as brokered deposits and borrowings, than do banks on the U.S. mainland (see Chart 4). Non-core funding to total liabilities was double the U.S. average—69 percent of liabilities for local banks compared with 35 percent for U.S. banks.
- High levels of non-core funds and rising short-term interest rates have contributed to a widening gap between funding costs among institutions headquartered in Puerto

Rico and USVI compared with those on the U.S. mainland (see Chart 5).

- Non-core funding typically is more sensitive to changes in interest rates than core deposits. Additional increases in short-term interest rates or continued flattening in the yield curve may pressure NIMs.
- Competition for core deposit growth in Puerto Rico remains intense. In addition to the challenge posed by the large unbanked population, estimated to be half of the total population, a large number of non-bank financial companies also compete for deposits. To increase their core deposit base, some local institutions have established branches in the U.S. mainland, particularly in Florida.



¹Source: Brean Murray Research.

Puerto Rico and the U.S. Virgin Islands at a Glance

ECONOMIC INDICATORS (Change from year ago, unless noted)

Employment Growth Rates	Q2-05	Q1-05	Q2-04	2004	Q2-04
Total Nonfarm (share of trailing four quarter employment in parentheses)	-0.3%	1.1%	2.3%	1.7%	3.9%
Manufacturing (11%)	-1.0%	-1.1%	0.7%	-0.3%	0.1%
Other (non-manufacturing) Goods-Producing (6%)	-2.4%	-0.4%	0.3%	-0.9%	0.2%
Private Service-Producing (53%)	-0.4%	1.3%	3.0%	2.2%	6.5%
Government (30%)	0.4%	1.9%	2.1%	2.4%	1.8%
Unemployment Rate (% of labor force)	11.2	10.6	10.5	10.6	12.0

BANKING TRENDS

General Information	Q2-05	Q1-05	Q2-04	2004	Q2-04
Institutions (#)	12	12	12	12	13
Total Assets (in millions)	100,965	97,336	85,831	93,703	78,275
New Institutions (# < 3 years)	0	0	0	0	0
Subchapter S Institutions	1	1	1	1	1

Asset Quality	Q2-05	Q1-05	Q2-04	2004	Q2-04
Past-Due and Nonaccrual Loans / Total Loans (median %)	3.66	4.12	4.38	4.35	4.80
ALLL/Total Loans (median %)	1.14	1.23	1.35	1.28	1.55
ALLL/Noncurrent Loans (median multiple)	0.57	0.52	0.51	0.55	0.62
Net Loan Losses / Total Loans (median %)	0.44	0.33	0.28	0.51	0.37

Capital / Earnings	Q2-05	Q1-05	Q2-04	2004	Q2-04
Tier 1 Leverage (median %)	6.97	6.86	6.87	6.88	6.78
Return on Assets (median %)	1.00	1.29	1.49	1.35	1.16
Pretax Return on Assets (median %)	1.36	1.49	1.72	1.65	1.37
Net Interest Margin (median %)	3.15	3.07	3.20	3.21	2.96
Yield on Earning Assets (median %)	5.68	5.36	4.92	4.98	5.35
Cost of Funding Earning Assets (median %)	2.57	2.37	1.89	2.00	2.36
Provisions to Avg. Assets (median %)	0.18	0.18	0.27	0.31	0.42
Noninterest Income to Avg. Assets (median %)	0.46	0.55	0.51	0.62	0.64
Overhead to Avg. Assets (median %)	2.01	2.06	2.00	2.13	2.23

Liquidity / Sensitivity	Q2-05	Q1-05	Q2-04	2004	Q2-04
Loans to Assets (median %)	53.9	53.9	54.1	54.4	55.0
Noncore Funding to Assets (median %)	63.2	59.0	58.1	59.1	59.7
Long-term Assets to Assets (median %, call filers)	44.1	49.3	46.6	40.1	39.9
Brokered Deposits (number of institutions)	9	9	9	9	10
Brokered Deposits to Assets (median % for those above)	12.4	11.2	11.7	11.3	13.7

Loan Concentrations (median % of Tier 1 Capital)	Q2-05	Q1-05	Q2-04	2004	Q2-04
Commercial and Industrial	105.6	92.8	102.6	82.1	143.3
Commercial Real Estate	184.9	177.8	184.9	175.6	194.0
Construction & Development	51.7	40.8	41.1	39.8	58.5
Multifamily Residential Real Estate	0.2	0.5	0.4	0.2	0.0
Nonresidential Real Estate	119.2	118.0	125.4	120.8	143.7
Residential Real Estate	243.5	249.0	314.2	251.7	306.0
Consumer	40.4	44.4	66.5	48.3	90.0
Agriculture	3.9	3.0	3.2	3.1	0.1

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
San Juan-Caguas-Guaynabo, PR	11	38,404	< \$250 million	2 (16.7%)
Ponce, PR	11	1,868	\$250 million to \$1 billion	0 (0%)
Aguadilla-Isabela-San Sebastian, PR	7	1,132	\$1 billion to \$10 billion	6 (50%)
Mayaguez, PR	11	1,112	> \$10 billion	4 (33.3%)
San German-Cabo Rojo, PR	4	637		